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Delivered by E-mail

Nancy McNeil
Regulatory Affairs Officer/Clerk
Nova Scotia Utility and Review Board
3rd Floor 1601 Lower Water Street
PO Box 1692 Unit "M"
Halifax NS B3J 3S3

Dear Ms. McNeil:

Re: An Application by NSPI for Approval of Capital Work Orders:
CI 39323, Digby Wind Project ($70,758,698)
CI 39626, Digby Wind Project Substation ($4,586,277)
CI 39627, Digby Wind Project Network Upgrades ($4,156,325)
CI 39628, Digby Wind Project Interconnection ($3,270,060)

This letter is filed on behalf of our clients, the Avon Group and will focus on two areas of concern: (1) the economics of the project; and (2) compliance with the Code of Conduct.

BACKGROUND

Nova Scotia Power Inc. ("NSPI") has purchased from an affiliate, 3240384 Nova Scotia Limited (324 NSL), the assets and development rights associated with the Digby Wind Project, a 20 turbine wind farm generating 30 megawatts (MW) of wind energy. NSPI has requested Board approval pursuant to s.35 of ***The Public Utilities Act*** of the four capital work orders comprising the Digby Project at a forecast cost of $82.8 million.

The original developer and Power Purchase Agreement (PPA) counterparty, Sky Power went into creditor protection in August of 2009, following which 324 NSL purchased the assets and development rights.

324 NSL entered into a construction contract with a second affiliate, Emera Utility Services (EUS) to construct the Project for a fixed price plus a bonus if the Project was substantially complete by December 20, 2010 – the contracted date for completion. The Project has now been constructed and is substantially complete in accordance with the contract terms.

ECONOMIC ANALYSIS

If NSPI's economic analysis is accepted, the levelized cost of energy for the next 20 years compares favourably to the SkyPower PPA. However, prudence requires careful scrutiny of the embedded costs.

NSPI asserts that acceptance of the capital application results in a net present value (NPV) of $4.9 million when comparing the levelized costs over the 20 year period to the SkyPower PPA.

Since the time of the filing, NSPI entered into an Operation Support Agreement with GE, the turbine supplier. The signed contract costs are *lower* than what was forecast when NSPI filed its application, resulting in an improved NPV.[1] In addition, the construction costs will be at least $2.0 million lower than anticipated at the time of filing, again bettering the NPV.[2]

While these are beneficial changes, it is noted that when NSPI performed its analysis, it used forecasted annual production of 100,380 MWh (10 year average). This output is considerably higher than the energy bid under the PPA. Using a comparable output as the energy bid under the PPA, and even accounting for the favourable updated construction costs, the economics reverse and favour the original PPA over this capital Project by some $12.1 million.[3]

Using a 100,000 MWh production, the economics still favour the original PPA over this Application by some $2.3 million.[4]

NSPI notes that the Garrad Hassan report upon which NSPI relies for its output forecast indicates that it is 90% likely that the 10-year average will be at least 98.9 GWh; the 110.4 GWh production value used in NSPI's application is the P50 estimate according to Garrad Hassan.[5]

The issue of a P50 assumption to calculate the total energy produced versus the use of P90 was an issue as well in the Nuttby Wind Farm application. At the time, NSPI had pointed out that a P50 value is often used for equity purposes and a P90 value used in sizing debt and for debt service coverage ratios. The Board stated this with respect to the use of P50 analysis:

> *[44] The Board is satisfied with the estimates as filed for purposes of approving this Application. NSPI advises that the approach they have taken is a long-standing and traditional approach to economic analysis of capital utility investment. The Board is hesitant to make any general finding or direction with respect to a P50 versus a P90 analysis as it relates to future applications. If intervenors wish to pursue this issue as it relates to future*

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[1] Undertaking U-8.

[2] Undertaking U-12.

[3] Undertaking U-12.

[4] Undertaking U-12.

[5] Response to U-12 and Appendix 11.

> *work order applications, the Board is prepared to hear further submissions.*[6]

At this stage, neither the Avon Group nor the Board is in any better position to evaluate the reasonableness of the use of P50 versus P90. No additional information on the reliability of the Garrad Hassan probabilities has been made available.

The Avon Group recommends that the Board direct NSPI to submit a report correlating its actual output to the assumed output on which its economic analysis are based for the wind projects which have been taken into rate base (and any other wind projects in Nova Scotia). To the extent such information is currently available, NSPI could undertake to file it prior to the Board's decision (recognizing that the time horizon would be quite limited) such that this Board and Intervenors would have greater comfort in the use of the P50 assumption for the economic analysis.

CODE OF CONDUCT

NSPI is the principal operating subsidiary of Emera Inc. and wholly owned by it. Emera's business activities are not subject to regulation by the Board. In order to ensure that transactions NSPI enters into with affiliates are *designed and carried out* to produce demonstrable benefit to NSPI's customers, the Board mandated that NSPI adopt a Code of Conduct which was approved in its current form, effective June 1, 2009.[7]

As a general statement of principles:

> *2.2 NSPI will only enter into affiliate transactions when doing so has been demonstrated through sound, documented analysis to be the best available option for NSPI's customers at the time.*

The Code sets out principles of fair dealing (among other reasons), to avoid subsidy by NSPI of the costs, revenues, or activities of affiliates (6.0, Objectives). The protocols under the Code of Conduct include:

> *6.7 NSPI will charge and be charged prices which reflect fair market value (FMV) for all non-regulated utility goods, services, leases, asset transfers, or other exchanges of value provided to or from affiliates, provided that in all cases NSPI shall charge for such goods and services no less than its fully allocated costs.*
>
> *6.8 NSPI shall determine and document all FMV prices through use, where practicable, of competitive tendering or quotes; otherwise NSPI shall use the most direct alternative means of establishing FMV pricing, including*

[6] Re Nova Scotia Power Inc., 2009 NSUARB 179; NSPI-P-128.09.

[7] Exhibit N-8, Order NSUARB-NSPI-P882, NSPI Revised Code of Conduct Governing Affiliate Transactions.

> *without limitation benchmarking studies, catalog [sic] pricing or recent markets transactions.*
>
> *6.10 Where a capital asset is transferred from NSPI to an affiliate or from an affiliate to NSPI, that asset will be transferred at a price to be approved by the Board in advance.*

Section 7.6 describes the actions to be taken by NSPI to establish that each transaction with an affiliate is ***demonstrably the best option from among those reasonably available at the time for its customers***. These include (a) contemporaneous documentation of efforts undertaken to identify commercially available alternatives and a description of the basis for the decision to transact with an affiliate; and (b) a summary table or a narrative identifying the alternatives considered, material criteria used in deciding with whom to transact, a comparison of the alternatives and the reasons for selecting an affiliate.

The documentation is also required to contain summaries of verbal communications affecting the decision to transact with an affiliate and, for large transactions (i.e. over $500,000), NSPI must prepare an analysis of the cost of self-provisioning, describe solicitations from third party suppliers and produce a documented analysis (7.8).

In the event that solicitation of third-party offers is not used for a large transaction, NSPI is required to prepare a justification describing the alternate means used to identify alternatives, its evaluation criteria and a description of the process and reasons for choosing to transact with an affiliate (7.9).

Clearly, the multi-million dollar untendered contract granted to EUS would not meet the Code of Conduct.

In this case, NSPI has stated it was not directly involved in negotiation of the contract between 324 NSL and EUS. Accordingly, it is unable to comment on the appropriateness of the decision to contract with EUS and whether the price was based on an engineered cost or whether EUS simply beat the alternatives.[8] NSPI urges the Board not to consider whether the 324 NSL-EUS agreement itself is "demonstrably the best option" but instead, to accept that the overall "value" of the project has been maintained by EUS as compared to certain the original SkyPower bids (as adjusted by NSPI) and an engineering analysis.[9]

The curtain drawn by NSPI around the 324 NSL-EUS transaction should be pulled aside in these circumstances. As stated by Mr. Bennett on cross-examination:

> *Mr. Bennett: ... We endeavoured from the beginning – our intention from the beginning has always been to put the assets that naturally belong in a regulated utility in a regulated utility because we believe that*

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[8] Cross-examination of Mr. Bennett, Transcript, p. 32

[9] NSPI (CA) IR-3

that's where the most value is created for customers and, quite frankly, because it fits our business model of operating at regulated enterprises.

Ms. Rubin: *Okay, and what is the beginning? You said, "we endeavoured from the beginning."*

Mr. Bennett: *From the beginning of being notified that the project was in bankruptcy and that – and from our beginning understanding that we needed that project in one form or another to comply with renewable energy standards.*

Mr. Rubin: *And when was that?*

Mr. Bennett: *That was early fall of 2009.*[10]

NSPI participated in the purchase of SkyPower's assets under the *Companies Creditor Arrangement Act* ("CCA") process, with Ms. McKinnon undertaking the initial due diligence for NSPI, as well as assisting Emera in its due diligence process.[11] It was NSPI which commissioned the Garrad Hassan report at the end of September 2009 with the intent that NSPI would develop the wind project although, in the end, it was issued to Emera and paid for by Emera.[12]

NSPI states that it stepped away from the project in December of 2009 and was not involved in the negotiations between 324 NSL and EUS which took place in early January culminating with the contract of February 9, 2010.[13] The facility with which NSPI stepped away from the transaction defies common sense, particularly when it knew or fully intended that the contract would be funded by ratepayers.

It is extremely difficult to be satisfied that the EUS lump sum price is the best price for NSPI customers and did not simply better a known alternative. At the time that EUS established its price, EUS had in its possession the CBCL benchmarking price summary as well as the eight bids and pricing information received under the solicitation conducted by SkyPower. In addition, EUS, unlike other bidders, was provided *revised* turbine location layout drawings, *revised* scope description of "Balance of Plant" construction requirements and "revised" substation location.[14]

The deal smacks of preferential treatment. Clearly, if NSPI was in the position of 324 NSL, it would be in breach of the fair dealing requirements of the Code of Conduct. This is not to say

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[10] Transcript, pp.83-84 and see also, Transcript, p. 123

[11] Transcript, pp.202-203.

[12] Cross-examination of Ms. McKinnon, Transcript, pp.233-234.

[13] Response to Undertaking U-6.

[14] NSPI Response U-1

that EUS is not the best deal, but in the circumstances, at the time of the decision and even now, we simply do not know.

Even looking at the pricing comparators offered by NSPI ex post-facto, the evidence is slim that this is the "best option" for customers. To justify the value of the EUS contract, NSPI compared the initial CBCL estimate with a revised CBCL engineering estimate which it states it secured when doing its due diligence on the deal. The second estimate came in at 4.8% less than the first. NSPI then reduced the eight SkyPower bidders by a similar 4.8% (and adjusted for padmounts and project management), concluding that the EUS price was superior.

However, the bids assumed a winter build and a "very compacted construction schedule" and did not account for the reductions due to movement of the turbines to the west of the project area[15]. Two of the bidders had identified a number of areas where a comprehensive value engineering analysis would likely result in a "significant reduction" of project construction costs.[16] Unfortunately, without having had the opportunity to re-bid or be involved in the negotiations, neither ratepayers, nor the Board can state what this "significant reduction" might equate to and whether it would be along the lines of the 4.8% reduction suggested by NSPI.

The best comparator to the EUS contract would be CBCL's re-scoped engineering estimate given that the bids are not an apples to apples comparison. The variance between the engineering estimate and the EUS contract is marginal.

Is the EUS contract a "reasonable" deal? Perhaps. Is it the "best available option"? One cannot say in the absence of a competitive solicitation and particularly in this circumstance where the affiliate was privy to information not made available to non-affiliated bidders. The Avon Group submits that where it was always intended that the Project would be taken into rate base, NSPI cannot simply turn a blind eye to the preferential treatment afforded its affiliate and use an after-the-fact justification.

The Avon Group respectfully submits that at minimum, the bonus granted between affiliates for completing the project in accordance with the contract deadline[17] ought to be disallowed. Beyond the bonus, it may be appropriate to reduce the percentage contingency allowance used in the CBCL engineering estimate to the comparable level allocated to the bids, noting that none of the bids had an allowance which approached the magnitude of the CBCL estimate.[18] Given that the Digby Wind Project has now come in under budget, it would appear that the degree of contingency was not warranted in any event. The Avon Group recommends a disallowance in respect of the contingency of $1.5 million.

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[15] Transcript, pp.77-78 and NSUARB (CA) IR-3

[16] NSPI (CA) IR-3, Attachment 1.

[17] Transcript, pp.90-92.

[18] NSPI (CA) IR-2, Attachment 2 (confidential)

Of course, the final Project costs must be approved by the Board which should be net of these disallowances.

CONCLUSION

If the Board is satisfied with the P50 assumption such that the economic analysis is in favour of this project, then subject to the disallowances recommended, the Avon Group does not object to NSPI's request for approval of these capital expenditures. However, the Avon Group requests the Board:

(a) direct NSPI to submit a report on the validity of the P50 assumption;

(b) disallow the affiliate bonus and $1.5 million of contingency; and

(c) require NSPI to submit its final costing to the Board net of the above sums.

Respectfully Submitted,

Nancy G. Rubin

NGR/lmc

c. NSPI, Intervenors